

**DEPARTMENT OF EDUCATION INCLUDING
DIRECT AID TO PUBLIC EDUCATION,
THE VIRGINIA SCHOOLS FOR THE DEAF AND BLIND,
AND THE VIRGINIA SCHOOLS FOR
THE DEAF AND BLIND FOUNDATION
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2003**



AUDIT SUMMARY

Our audit included the Department of Education, Direct Aid to Public Education, the Virginia School for the Deaf and Blind in Staunton, the Virginia School for the Deaf, Blind, and Multi-disabled in Hampton, and the Virginia Schools for the Deaf and Blind Foundation. Our audit of the year ended June 30, 2003, found:

- proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System for the Department of Education, Direct Aid to Public Education, the Virginia School for the Deaf and Blind in Staunton, the Virginia School for the Deaf, Blind, and Multi-disabled in Hampton;
- proper recording and reporting of transactions, in all material respects, in the accounting records for the Virginia Schools for the Deaf and Blind Foundation;
- no matters involving the internal control and its operation that we consider material weaknesses; and
- no instances of noncompliance that are required to be reported.

The Department of Education is the designated fiscal agent for the Comprehensive Services Act and we will issue a separate report on this activity.

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THE DEPARTMENT'S FUNCTIONAL AREAS

The Department of Education has four functional areas:

- Central Office
- Direct Aid to Public Education
- Virginia School for the Deaf and Blind in Staunton; Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton; and the Virginia Schools for the Deaf and Blind Foundation
- Comprehensive Services Act for At-Risk Youth and Families

The Department's Central Office supervises the public school systems; provides training and technical assistance; and monitors their compliance with laws and regulations for all 132 school divisions. The Department assists these school divisions, colleges, and universities in helping teachers and other staff improve their skills, and licenses and certifies school personnel. The Department also acts as the pass-through agency for state and federal funds and determines the distribution of state money to local school divisions through direct aid to local school divisions.

During fiscal year 2003, the Department transferred over \$4.4 billion in state and federal funds to local school divisions. State dollars make up the majority of these funds, which support the Standards of Quality.

The Department maintains operating controls over the two schools for the deaf and blind. The schools provide comprehensive instructional programs and services to children with serious auditory and visual impairments and multi-disabilities that local school divisions cannot serve. The State Board of Education is the governing body of the Virginia Schools for the Deaf and Blind Foundation. The Foundation promotes the growth, progress, and welfare of the Schools for the Deaf and Blind.

The Department of Education is the designated fiscal agent for the Comprehensive Services Act (CSA) for At-Risk Youth and Families. Central Office staff process pool fund payments to localities for services performed assisting at-risk youth. There is a separate report for CSA.

FINANCIAL OPERATIONS

Overview

The Department primarily receives General Fund appropriations. The Department also receives federal grants, collects fees for teacher licensure, and authorizes Literary Fund disbursements. The Schools for the Deaf and Blind receive funds from local school divisions and federal grants, and income from the Virginia Schools for the Deaf and Blind Foundation.

The Department acts as a pass-through agency for state and federal funds and determines the distribution of funds to local school divisions. Over \$4.4 billion in funding goes through to local school divisions for primarily Direct Aid to Public Education and local school functions.

Standards of Quality funding makes up approximately 60 percent of all aid sent to local school divisions with another 20 percent from Special State Revenue Sharing. Special State Revenue Sharing consists of a portion of net revenue from the state sales and use tax and lottery profits. Sales and use tax disbursements go to each school division using census data of school-age children within the school divisions. The school divisions receive lottery profit allocations based on the number of students reported for each school division in the spring multiplied by the per pupil amount determined by the General Assembly. The Department allocates funds to each locality based on information gathered from local school divisions, following the provisions outlined in the Appropriations Act and federal grant agreements.

The schedules below summarize the Department's budgeted revenues with actual results.

Summary Analysis of Appropriations and Revenue by Functional Area

<u>Functional Area</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual</u>	<u>Percentage of Total Funding</u>
Direct Aid to Public Education:				
General Fund	\$3,916,513,778	\$3,921,158,180	\$3,921,158,180	
Special Funds	145,248,145	167,647,880	167,166,909	
Federal Fund	<u>575,910,441</u>	<u>725,591,718</u>	<u>580,968,685</u>	
Total	<u>4,637,672,364</u>	<u>4,814,397,778</u>	<u>4,669,293,774</u>	98.3%
Central Office Operations:				
General Fund	47,726,517	44,711,758	44,711,758	
Special Funds	10,791,152	3,453,873	2,131,384	
Federal Fund	<u>22,280,831</u>	<u>33,690,246</u>	<u>21,089,944</u>	
Total	<u>80,798,500</u>	<u>81,855,877</u>	<u>67,933,086</u>	1.4%
Virginia Schools for the Deaf and Blind:				
General Fund	12,958,639	12,254,233	12,254,233	
Special Funds	658,787	811,855	815,017	
Federal Fund	<u>438,525</u>	<u>658,024</u>	<u>611,159</u>	
Total *	<u>14,055,951</u>	<u>13,724,112</u>	<u>13,680,409</u>	.3%
Total *	<u>\$4,732,526,815</u>	<u>\$4,909,977,767</u>	<u>\$4,750,907,269</u>	<u>100.0%</u>

Analysis of Budgeted and Actual Expenses by Fund

<u>Functional Area</u>	<u>Adjusted Budget</u>	<u>Actual Expenses</u>	<u>Variance</u>
Direct Aid to Public Education:			
General Fund	\$3,921,158,180	\$3,911,321,982	\$ 9,836,198
Special Funds	167,647,880	167,403,980	243,900
Federal Fund	<u>725,591,718</u>	<u>561,778,162</u>	<u>163,813,556</u>
Total	<u>4,814,397,778</u>	<u>4,640,504,124</u>	<u>173,893,654</u>
Central Office Operations:			
General Fund	44,711,758	42,559,815	2,151,943
Special Funds	3,453,873	1,927,737	1,526,136
Federal Fund	<u>33,690,246</u>	<u>20,120,300</u>	<u>13,569,946</u>
Total	<u>81,855,877</u>	<u>64,607,852</u>	<u>17,248,025</u>
Virginia Schools for the Deaf and Blind:			
General Fund	12,254,233	12,222,612	31,621
Special Funds	811,855	743,855	68,000
Federal Fund	<u>658,024</u>	<u>544,388</u>	<u>113,636</u>
Total *	<u>13,724,112</u>	<u>13,510,855</u>	<u>213,257</u>
Total *	<u>\$4,909,977,767</u>	<u>\$4,718,622,831</u>	<u>\$191,354,936</u>

Source: Original Budget includes those funds as appropriated in the 2002 Acts of Assembly (Chapter 899).

Adjusted Budget includes the 2003 Acts of Assembly (Chapter 1042), as well as any changes made during FY 2003.

* Does not include capital project appropriations and expenditures incurred by the Virginia Schools for the Deaf and Blind.

The budgets for Direct Aid to Public Education (Direct Aid) and Central Office operations increased during the fiscal year as a result of increases in funding for Standards of Quality and federal programs.

The Direct Aid budget for special funds slightly increased due to the state's share of teacher's retirement and social security contributions. The decrease in Central Office's special fund budget is the result of a \$7.9 million transfer from special fund appropriations to federal funds. The Appropriation Act showed these funds incorrectly classified as special funds rather than federal funds.

The variance in the federal funds between the adjusted budget to actual revenue and expenses occurs for several reasons. The Department originally compiled the federal budget estimates of award amounts up to two years in advance. The Department does not receive notification of actual award amounts or new programs until the beginning of the fiscal year, which is more than a year after the approval of the amended budget. Therefore, the Department requested increases to appropriations for new grants and increases in federal award amounts during the fiscal year.

For federal grants that the Department passes through to the local government level, the Department recognizes federal revenue only as it requests and receives funds, which occurs after the local schools spend the money. This means that localities must spend their own funds and then request reimbursement of the costs from the federal government through the Department's Central Office.

The Department requires additional start-up time for new awards to establish administrative support, communicate federal requirements and standards, and allocate funding to the localities. Once the localities receive notice of their grant allocation amount and program requirements, the localities also require time to implement new programs. This results in fewer expenses during the first state fiscal year of award availability than in the following years. In addition, unanticipated increases in existing awards have a similar impact on state and local government. When unanticipated additional funds become available, it requires time for localities to develop new or adapt existing programs that comply with grant conditions prior to requesting additional program funds. Most federal grant programs contain extended periods of availability to allow the localities time to establish their programs and request reimbursements, which allows the Department and local school divisions to maximize their use of federal dollars.

The Department received several new grant programs and unanticipated increases in several existing programs such as Special Education (\$35 million) and School Nutrition (\$20 million), and in programs under the No Child Left Behind Act (\$88.1 million). Central Office operations received an additional \$3.2 million in federal awards under the Title II Teacher Quality Grant.

In the analysis of budgeted and actual expenses, the General Fund variance for Direct Aid occurred in the Special State Revenue Sharing program. The Department's appropriation includes estimated expected sales tax collections, which were lower than expected due to a decline in the economy.

The General Fund variance for Central Office operations is the result of management's expense reductions and cost savings across the Department in accordance with the Governor's directive for budget reductions and to reduce administrative spending, which was reverted. The federal fund variance is the result of federal dollars appropriated based on federal award amounts that have not yet been used for its intended purpose.

As illustrated below, the majority of the Department's expenses are transfer payments, which are comprised mostly of Direct Aid. The largest contractual provider to the Department, Harcourt Brace, which administers grades and evaluates Standards of Learning tests, received approximately \$21,108,130 million during fiscal year 2003.

Direct Aid to Public Education and Central Office Operations Expenses by Object Code

<u>Expenditure Class</u>	<u>FY 2003</u>
Personal Services	\$ 21,360,874
Contractual Services	60,661,833
Supplies and Materials	632,079
Transfer Payments	4,620,218,363
Continuous Charges	1,400,037
Equipment	<u>838,790</u>
Total *	<u>\$4,705,111,976</u>

Source: Commonwealth Accounting and Reporting System for the Department of Education and Direct Aid to Localities

* Does not include expenditures incurred by the Virginia Schools for the Deaf and Blind.

Direct Aid to Public Education Expenses by Program Area

<u>Programs</u>	<u>Amount of Direct Aid to Public Education *</u>	<u>Percentage of Direct Aid to Public Education</u>
Standards of Quality	\$2,782	60%
Special State Revenue Sharing	940	20%
Categorical Aid	485	11%
Public School Employee Benefits	187	4%
Other	<u>247</u>	<u>5%</u>
Total	<u>\$4,641</u>	<u>100%</u>

* in millions

Source: Commonwealth Accounting and Reporting System for the year ended June 30, 2003

The Standards of Quality set minimum standards for programs and services each local school board should provide. The Department allocates funds to each locality based on information gathered from local school divisions, following the provisions of the Appropriations Act and federal grant agreements. In addition to providing funds to localities, the Department also transfers federal assistance to other state agencies that administer educational programs.

The Department calculates most state entitlement payments based on the average daily membership for each school division and the total departmental appropriation. At the beginning of the fiscal year, the Department calculates 24 equal installment payments to each school division. After each school division reports its actual average daily membership as of March 31, the Department adjusts the remaining installment payments to reflect each school division's actual average daily membership. The following table shows expenditures in Direct Aid over the last five years. In 2003, total Direct Aid increased more than \$131 million due to an increase in student enrollment and per pupil costs.

	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>
Direct Aid to Localities Expenditures *	\$3,874,590	\$4,065,104	\$4,366,265	\$4,457,357	\$4,640,504
Total Students	1,110,846	1,121,780	1,130,446	1,143,018	1,156,471
Per Pupil Expenditure **	\$ 3,488	\$ 3,624	\$ 3,862	\$ 3,900	\$ 4,013
Total Teachers	84,283	85,817	89,872	89,831	101,594***

* Dollars in thousands

** Per Pupil Expenditure is the Direct Aid to Localities Expenditures divided by Total Students

***Preliminary estimate

DEPARTMENT HIGHLIGHTS

Standards of Accreditation

The Board of Education adopted revisions to the Regulations Establishing Standards of Accrediting Public Schools in Virginia. The revisions became effective September 28, 2000 for the 2000-2001 school year. The regulations include provisions that raise academic achievement standards for students, increase the high school graduation requirements, increase instructional time, and establish a school report card for parents and the community. Student achievement on Standards of Learning tests will continue to provide the primary basis for evaluating schools.

Standards of Learning

The Board of Education establishes the Standards of Learning and adopted revisions during fiscal year 2001. The standards are minimum requirements for students in the following subjects: English; mathematics; science; history/social science; computer/technology; visual and performing arts; foreign language; health; physical education; and driver education. The standards set targets and expectations for both teachers and students. The Board also approved a review schedule for all Standards of Learning in each subject area at least once every seven years.

Governor's Schools

Virginia has 43 Governor's Schools, a state and local supported program that includes summer residential, summer regional, and academic-year programs serving more than 7,200 gifted students. The schools consist of 7 Summer Residential Governor's Schools, 20 Summer Regional Governor's Schools, and 16 operational Academic-Year Governor's Schools. The Summer Residential Governor's Schools provide gifted high school juniors and seniors educational experience in visual and performing arts, humanities, mathematics, science, technology, medicine, life science, engineering, and marine science. The Summer Regional Governor's Schools that serve gifted elementary and middle school students provide educational experience in arts, science, and humanities. The Academic-Year Governor's Schools provide subjects including arts, government and international studies, global economies and technology, mathematics, science, and technology.

Charter Schools

Charter schools are public, nonsectarian, nonreligious, or nonhome-based alternative schools located within a public school division. A charter school may be a new public school or the conversion of all or part of an existing public school. Any person, group, or organization may submit an application to develop a charter school to the local school board in school divisions that have adopted resolutions to accept such applications. Charter schools may receive state and federal funding and are subject to the requirements of the Standards of Quality, including the Standards of Learning and the Standards of Accreditation.

Currently, there are eight charter schools in Virginia with a total estimated 2002-2003 enrollment of 685 students spanning grades 3 through 12. This includes four schools with grade 9-12 programs, two schools with grade 6-8 programs, one school with a grade 3-12 program, and one school with a grade 6-12 program.

VIRGINIA SCHOOLS AND FOUNDATION FOR THE DEAF AND BLIND

The Virginia School for the Deaf and Blind in Staunton and the Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton provide educational services for students with sensory impairments from birth to age 22. The schools have an advisory commission that monitors operations and submits recommendations to the Board of Education. The schools provide academic and vocational education, as well as other services such as speech, therapy and health services, and guidance counseling. During fiscal year 2003, the Virginia School for the Deaf and Blind in Staunton served 155 students and the Virginia School for the Deaf, Blind and Multi-Disabled served 84 students.

The Schools for the Deaf and Blind expenses for fiscal year 2003 totaled \$13,510,855. Of this amount, \$10,833,637 (80 percent) was for personal service expenses, \$1,218,321 (9 percent) was for contractual service expenses, and the remaining \$1,458,897 (11 percent) was for supplies and materials, equipment, and on-going charges.

In fiscal year 2003, as a result of statewide budget reductions, the Virginia School for the Deaf and Blind at Staunton and the Virginia School for the Deaf, Blind, and Multi-Disabled at Hampton had to reduce their General Fund appropriations by \$207,949 and \$400,418, respectively. In addition to these reductions, the School at Staunton reverted \$6,384 and the School at Hampton reverted \$354 at fiscal year-end. The Schools at Staunton and Hampton anticipate additional budget reductions for fiscal year 2004 of \$7,174 and \$647,924, respectively.

Analysis of Budget and Actual Revenue by Funding Source

<u>Funding Source</u>	<u>Original Budget</u>	<u>Adjusted Budget</u>	<u>Actual</u>
General Fund Appropriations	\$12,958,639	\$12,254,233	\$12,254,233
Non-General Funds	658,787	811,855	815,017
Federal Grants	<u>438,525</u>	<u>658,024</u>	<u>611,159</u>
Total *	<u>\$14,055,951</u>	<u>\$13,724,112</u>	<u>\$13,680,409</u>

Source: Chapter 1042 Acts of Assembly and CARS 402 C1 Report as of June 30, 2003

* Does not include capital project appropriations and expenditures incurred by the Virginia Schools for the Deaf and Blind.

The Virginia Schools for the Deaf and Blind Foundation, Incorporated, supports and aids the schools in the existing and future enterprises involving the Schools. The Foundation administers gifts, grants, bequests, and devises consistent with their terms and for the benefit of the Schools for the Deaf and Blind. The State Board of Education approves the Foundation's budget and acts as its governing board. The Assistant Superintendent of Finance serves as the Secretary/Treasurer of the Foundation, oversees the actions of the Foundation's investor, and reports financial activities to the Board of Education. Annually, the Schools receive income from the Foundation's investments, which they must spend in accordance with a plan submitted to the Foundation's board. The Foundation operates on a calendar year. From January 1, 2002 to December 31, 2002, the Foundation paid \$46,681 to the Staunton school and \$40,160 to the Hampton school.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218**

December 29, 2003

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Vice Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Education including the Direct Aid to Public Education, the Virginia School for the Deaf and Blind in Staunton, the Virginia School for the Deaf, Blind, and Multi-Disabled in Hampton, and the Virginia Schools for the Deaf and Blind Foundation** for the year ended June 30, 2003. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and in the Department's accounting records, review the adequacy of the Department's internal control, and test compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Expenditures
Revenues
Federal Grant Management

We obtained an understanding of the relevant internal control components sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the Foundation's accounting records. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and the Foundation's accounting records.

We noted no matters involving internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this report with management on February 3, 2004.

AUDITOR OF PUBLIC ACCOUNTS

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DEPARTMENT OF EDUCATION
Richmond, Virginia

BOARD MEMBERS
As of June 30, 2003

Thomas M. Jackson, Jr., President

Susan Genovese, Vice President

Mark E. Emblidge
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Thomas G. Johnson, Jr.
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